Speech

Improving Information for Investors in the Digital Age

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Thank you, Ken [Bertsch], for that kind introduction. I would like to start out by thanking the Council of Institutional Investors for inviting me to speak with you. It is a pleasure to be here.

I last spoke to you in May 2014 about "Building Momentum."[1] At the time, I was a rookie Commissioner. Now, I stand before you after five years as a Commissioner and over 5,700 votes under my belt. It has been an amazing time to be on the Commission, and I've learned a great deal about what matters to both companies and investors. Today, I'd like to share with you some of my thoughts borne from my experience. Specifically, my thoughts on how the Commission should improve disclosure to investors in the Digital Age.[2]

Nearly 100 years ago, the United States was undergoing an unprecedented amount of change. Growing companies provided Americans with new inventions, such as the car, electricity, the radio, and the skyscraper.[3] Instead of tweets, there were newspapers sold by paperboys on the street corners, who shouted out the day's headlines. Radio waves, invisibly sent through the air, let large numbers of Americans hear events as they happened—and it also shaped their opinions. Social media was thriving in the 1920s.

The United States was the world's wealthiest nation. The economy looked good—in fact, it was growing at an impressive rate. Unemployment was on a rapid decline—approaching 4%.[4] And, both retail and institutional investors were buying into a surging stock market.[5] Then, almost without warning, the country was reeling in an

unprecedented tailspin. Eighty-nine years ago tomorrow—October 24, 1929—our markets crashed in an event known as "Black Thursday."

After the stock market crash in 1929, Congress began to investigate the crisis and find solutions to the problems it uncovered. The investigation revealed investors' dissatisfaction with information they received about the companies they owned. For example, most companies only produced a balance sheet. And the companies that produced an income statement provided very little detail about the sources of their income and their operations. These voluntary disclosures weren't very useful, as there were different ways of reporting profit.[6] In essence, investors couldn't perform basic analysis or compare one company to another or the same company over different time periods.

Further, economic factors in the 1920s encouraged companies to withhold financial information or to disclose less than the amount of information desired by market participants. Company management said they were afraid too much disclosure would put their companies at a disadvantage when competing with other American companies and their foreign counterparts.

However, even when companies provided voluntary disclosures, investors and others questioned the veracity of the information. As one observer noted, "[t]he written records, the accounts of business transactions in a vast number of cases, were imperfectly, inaccurately or fraudulently stated."[7] This led Congress to find that "[t]here cannot be honest markets without honest publicity. Manipulation and dishonest practices of the marketplace thrive upon mystery and secrecy."[8]

This essential truth forms the bedrock of the Securities and Exchange Commission's mission. And it is as true today as it was 89 years ago. This is because, while the capital markets have evolved—new products and technology abound—the Commission's tools to help the markets thrive remain robust and flexible.

Often, I speak about the incredible pace of change in our capital markets. Our society, and our capital markets, are not just evolving, they are transforming before our eyes. Digital technologies offer new ways to more efficiently and effectively solve complex problems.

Looking across a room or across a subway car, instead of faces, we see small handheld computers. Smartphones. These small, but mighty devices are propelling unprecedented and fundamental changes in how we do things—how we parent our children, how we communicate, how we do business, how products and services are delivered, and how we invest.

We've been through similar transformations before. In some ways, we started this particular journey over 200 years ago (1792), when the telegraph set in motion a dramatic change in how we communicate. Later, the telephone improved upon this one-way method of communication. The advent of the radio (perhaps the first social medial

platform) allowed the telling of the same story to thousands of people at the same time. It also allowed people to call in with questions or comments. In the 1960s, the first emails were exchanged. In the 1970s, electronic bulletin boards were in vogue, as ARPANET (the early predecessor to the internet) was making new connections to colleges and universities. The 1980s revolutionized email with software applications that began blasting messages to many users at the same time. In the 1990s, the development of an easy to use and graphic-friendly web browser (Mosaic) accelerated and popularized the World Wide Web. This allowed nearly instantaneous sharing of information. From that platform, social networking and new forms of social media have flourished.

No matter the means of communication, timely, relevant, and reliable information has always been critical to the success of the American capital markets. Today in the Digital Age, the Commission faces the same question it faced 84 years ago—how to ensure that the markets have the best information environment possible.[9]

Much has changed since the Commission was created in 1934. Nonetheless, the fundamental principles adopted by the Commission—transparency and fair presentation still serve as a Rosetta Stone in today's Digital World. By applying these fundamental principles from the past, I believe we can find thoughtful ways to address the new challenges of the Digital Age. We have all the tools we need. We just need to apply them.

As I discussed earlier, there have been a lot of changes since the days when radio dominated the media landscape. Given these changes, there has been a debate about how the information needs of today's investors have changed. For example, on the one hand, we hear that public companies are "overloading" investors with information. In particular, they are so inundated that "it [is] difficult for investors to focus on the information that is material and most relevant to their decision-making."[10] Moreover, one report called information overload a "pressing concern."[11] However, I must reveal that during my five years on the Commission, I have not heard this concern expressed by even one investor. Not one.

In fact, it has been my experience that investors and others are asking for more information. In 2014, when the Commission sought comment on its disclosure framework, it received over 26,500 comments.[12] The "overwhelming response…seem[ed] to reflect an enormous pent up demand by disclosure recipients for more and better disclosure."[13]

This demand has not subsided. Just a few weeks ago, a group of institutional investors, asset managers, state treasurers, and others petitioned the SEC. They asked the Commission to require disclosure of environmental, social, and governance (ESG) information by publicly traded companies in a standardized format.[14] Indeed, third-party providers are already collecting and assembling information and data to provide ESG ratings on companies. And, institutional investors, asset

managers, financial institutions, and other stakeholders are increasingly relying on these reports and ratings to measure and assess a company's ESG performance over time compared to peers.[15] Furthermore, elsewhere in the world, we see legislation enacted to require periodic reporting of ESG information.[16]

Companies also are electing to *voluntarily* provide more information. A recent report noted the explosive growth of non-GAAP metrics. Ninety-seven percent of all S&P 500 companies disclosed some form of non-GAAP metric last year.[17] However, these metrics are not standardized or uniform. Many are based loosely on measures prescribed by generally accepted accounting principles (GAAP), but contain additions, subtractions, or other changes. Once used sparingly, non-GAAP metrics, such as adjusted operating income, Earnings Before Income Taxes Depreciation and Amortization (EBITDA), Adjusted Operating Income Before Depreciation and Amortization (Adjusted OIBDA), core earnings, average revenue per customer, and free cash flow are increasingly common.[18] Indeed, they have become nearly ubiquitous. However, non-GAAP metrics are often criticized because, for the most part, the non-GAAP numbers remove significant expenses and therefore may disguise financial performance. Nonetheless, one study found that companies may be rewarded for using non-GAAP metrics. These companies tend to produce quarterly earnings per share that exceed analysts' forecasts by 5 to 15 cents, not a penny or two.[19] As a result, some have raised the concern that such metrics are "designed to present results in a more favorable light."[20]

While these voluntary disclosures increase information to investors and the marketplace, I am concerned that the lack of uniform standards and the lack of comparability may result in presentations that are not fairly balanced or fairly presented. In effect, what non-GAAP metrics measure, or attempt to communicate, more often are in the eye of the preparer rather than the beholder. In fact, one analyst study showed that a popular non-GAAP metric, "core earnings" was on average 30% higher than earnings reported under GAAP. [21] Also, misaligned incentives, such as customized measures linked to executive compensation may fuel this growth.

The issue of non-GAAP metrics may be even more acute in the private markets, with forward-looking adjustments, such as speculative cost savings to be realized in the future, or go-forward revenue assumptions underlying loan documents. Even sophisticated investors, such as public pension funds, are potentially being left in the dark because these metrics are not uniformly defined and, often, they are unable to see the inputs or deductions from GAAP-determined measures.

Companies compute these customized measures differently, use different definitions for similar terms, and create bespoke titles such as "adjusted consolidated segment operating income." Moreover, companies change the way they compute their non-GAAP metrics from time to time. Some have characterized these custom measures as "fuzzy math" or "earnings

before bad stuff." Others value these non-standardized metrics as alternative measures for obtaining greater detail regarding management's assumptions. In fact, some argue that non-GAAP measures provide more and better information and that these metrics benefit investors and reduce uncertainty and risk.[22]

Key performance indicators (KPIs) are another type of measure increasingly being reported by companies. KPIs are metrics and data that companies use internally to measure their performance. But, more and more, companies are choosing to *publicly* report some of these measures. KPIs can be financial performance measures, such as same store sales, sales per square foot, customer churn rates, or sales conversion rates. But companies also use KPIs to present non-financial performance measures, such as customer retention, employee satisfaction, or even the number of "likes" they receive on social media platforms.

It is clear that, during the past decade, managers of U.S. companies are communicating more information about how they run their companies, perhaps in an effort to meet both the market's and investors' demand for more information. Alternative measures—such as non-GAAP metrics and KPIs—that were once used sparingly, now appear in a host of documents and situations, including road shows, analyst meetings, and quarterly earnings calls.

However, the lack of uniformity in definition, or computation methods, limits comparability. In addition, some fear these measures tend to be "detached from reality."[23] These concerns revolve around the actual quality of information companies are providing. Investors, analysts, and other market participants desire more high-quality information, not less. They want to ensure that information is useful and truthful. And companies are responding by providing more. However, uncertainty about the quality and veracity of the information may be contributing to a poor information environment.

Again, returning to our roots, we can learn much from the SEC's beginnings. In the 1930s, the SEC was focused on a debate about the form and content of financial statements. As I mentioned earlier, there wasn't much uniformity at the time.[24] The struggle then, as now, was how to imagine financial reporting as a form of social media—a means by which a company may effectively engage, communicate with, and inform its investors. As the SEC said in 1942, financial statements exist to "enlighten[]."[25] Accordingly, that's the starting point.

As the Commission explained, "[e]ven if [all significant data] had been given, there is an additional obligation to present the material in a way in which it will be useful to [both] the informed and less sophisticated readers." That requires further emphasis—the obligation is to ensure that disclosures are useful to everyone—both sophisticated and less sophisticated readers.

The Commission should not be focused on information overload or

decreasing the amount or timeliness of information in the market. Instead, the Commission should be focused on how to organize it and ensure that it is fairly presented. We should be encouraging better communication between investors and issuers to the benefit of both parties.[26] Since 1934, the Commission has insisted on full, complete, accurate, and informative disclosure. We should continue to do so in 2018 and beyond.

That does not mean that the Commission needs to impose its own standards. The Commission has historically looked to the private sector to help establish standards, which has created an important joint responsibility.[27] In particular, the accounting profession was instrumental in narrowing varying practices into financial reporting standards that were uniform and consistent (*e.g.*, GAAP).[28]

However, despite the growing integration of ESG disclosure into corporate reporting, there are still competing private groups and competing methodologies, leaving both companies and investors in a state of confusion. And that, in and of itself, is unsustainable.

Furthermore, the Commission's issuance of mere "guidance" regarding cyber-related disclosures falls short of providing useful and reliable disclosure, and it leaves companies in a state of quandary. The Commission should lead by helping to create standards for disclosure, using structured data and taxonomies, where applicable. Facilitating the establishment of standards resolves uncertainty and reduces the cost of information.

These are but two examples of how we should be improving disclosure. If capital moves to jurisdictions that are perceived to have higher quality disclosure systems, it may be too late to act. We, at the SEC, must improve both the end product and the system of disclosure so that our capital markets remain the gold standard.

In the past, I've suggested a number of ways to go about making such changes. For example, I have advocated for the formation of a Digital Disclosure Task Force to include investors, analysts, academics, companies, and technologists to leverage today's technology for a modern disclosure system. But even more importantly, the Commission needs to engage in overseeing, and encouraging, a robust information environment. And, as the early SEC did, one that fairly presents information that is relevant, reliable, and decision-useful. The Commission must work to set forth acceptable standards that contribute to the provision of useful information to investors. Quite simply, the Commission needs to focus on information that is relevant to today's investors. And, it goes without saying that the information must be trustworthy and credible.

As we all know, after the stock market crash in 1929, Congress adopted a disclosure-based framework for regulating the securities markets. The challenge for Congress was how to ensure that disclosures were fair and truthful.[29] One way Congress sought to achieve this was by allowing

investors to sue companies for false statements. Congress also imposed liability on those individuals responsible for these statements, including directors, officers, and underwriters. And, a third way Congress approached the problem of inaccurate information was to require the certification or validation of financial statements. The initial drafts of the "Truth in Securities" Act required government auditors to examine and validate corporate financial statements. But, Congress ultimately decided to turn to private, independent, public accountants for this task.[30] It is interesting to note that public accountants, at the time, were relatively unknown. *Fortune* described the auditor in 1932, as "walk[ing] in the shadow of virtual anonymity."[31] Others described auditors as appearing only when there were suspicions of "fraud or irregularity" and at times "investigating…secretly, often at night and on Sundays."[32]

When information credibility concerns again threatened confidence in our financial markets, Congress again stepped in. In 2002, Congress passed the Public Company Accounting Reform and Investor Protection Act (also known as Sarbanes-Oxley Act)[33] in response to a series of corporate frauds—in particular, Enron and WorldCom. The Sarbanes-Oxley Act was an overwhelmingly bipartisan effort (99-0 in the Senate; 334-90 in the House) to strengthen our capital markets. President George W. Bush quickly signed the bill into law, which was characterized as "the most far reaching reforms of American business practices since the time of [the Securities Act]."

The Act focused on restoring investor confidence through a number of reforms that enhanced corporate responsibility, strengthened financial disclosures, and combated corporate and accounting fraud. Congress also created the "Public Company Accounting Oversight Board," also known as the PCAOB, to oversee the activities of the public company auditing profession.

One of the biggest changes made by the new law was the expansion of the role of the public company auditor to include an independent examination of a company's internal controls over financial reporting. Prior to 2002, there was considerable debate about whether strong controls would reduce the incidence of financial reporting fraud.[34] Since that time, both companies and investors have benefited.[35]

For example, companies benefit by enjoying greater access to lower cost capital and increased liquidity. [36] Companies also have benefited with higher credit ratings, and lower costs of debt. In a survey of company CFOs, 85% said that the examination of internal controls has either "greatly" or "somewhat" helped their company.[37] Another study found that companies that did not have an independent assessment of their controls over financial reporting had lower aggregate market values than those with the assessments.[38]

Investors also have benefited by having higher confidence in a company's reported numbers.[39] In addition, studies have found reports that cite material weaknesses provide a meaningful signal of increased

fraud risk.[40] In fact, many investors believe that the independent auditor's role has been too circumscribed, and I think the early Commission would agree. As one former SEC Commissioner opined, following the events of the 1930s, "the auditor became the surest friend of the investor."[41] Later, in 1957, the Commission made its position clear: the auditor's "duty is to safeguard the public interest, not that of [the] client."[42] And the Courts agreed, calling the auditor, a "public watch-dog."[43]

For more than seventy years, the role of auditors and their central communications tool, the auditor's report, has remained largely unchanged—essentially a pass/fail report card. However, here, investors also are demanding more. Recent changes to audit standards in the United States and elsewhere around the world are revamping both the form and content of the auditor's report. The new auditor's report should provide investors with more meaningful information about the audit, including significant estimates and judgments, significant unusual transactions, and other areas of risk at a company. The new information from the auditor will add to the total mix of information available to investors when making voting and capital allocation decisions. This is a good start, but more needs to be done.

In fact, an early auditing manual from 1892 argued that "it is only by voluntarily accepting, and even increasing, the responsibilities of our position that we can hope to maintain and increase the large measure of public confidence that we at present enjoy."[44] The Digital Age presents that opportunity. The development of audit tools that leverage data and technology, including blockchain, could revolutionize the audit assurance model. This means that auditors could benchmark corporate data and expand their assurance beyond the financial statements.

The very nature of the auditor's privileged position provides him or her with information that may be valuable for investors. For example, auditors could offer their views on corporate culture, diversity, or cybersecurity preparedness. Moreover, the auditor could offer assurance to a company's audit committee about the fair presentation of non-GAAP measures, KPIs, or a host of other information communicated to investors. In effect, independent auditors remain an untapped resource. Their role should evolve to meet the changing information needs of investors.

Conclusion

Since its founding, the Commission has been concerned about creating a robust information environment that is characterized by full, complete, accurate, and informative disclosure. The Commission should ensure that its disclosure system meets the needs of investors by providing information that is truthful and useful. We must remember the principal outlined by President Roosevelt during the creation of the SEC: "What we seek is a return to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using

other people's money are trustees acting for others."[45]

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[1] Commissioner Kara M. Stein, Remarks to the Council of Institutional Investors, May 8, 2014, *available at* https://www.sec.gov/news/speech/2014-spch050814kms.

[2] The views I express today are my own, and do not necessarily reflect those of my fellow Commissioners or the SEC staff.

[3] "My father's generation was the one that really saw the most amazing changes. He was born in 1900 in a world in which the horse was the main means of getting about. The car seemed to me more revolutionary in a way than anything that has happened since. It totally changed the kind of space we live in."— John Updike, Author, Little Traders 2 Blog, *The World of Little Traders: Life in the 1920s* (Dec. 18, 2015), *available at* https://www.littletradersgame.com/blog/2015/12/18/littletraders-world.

[4] *See* Stanley Lebergott, Annual Estimates of Unemployment in the United States, 1900-1954, National Bureau of Economic Research (1957), *available at* http://www.nber.org/chapters/c2644.

[5] In the 1920s, an industrial revolution in the United States fueled the rapid expansion of the scale and scope of the U.S. stock market. During that time, two factors affecting both the supply and the demand of stocks led to a dramatic expansion of the New York Stock Exchange (NYSE). First, banks and insurance companies (institutional investors) and retail investors increased their demand for stock. Second, more developing companies and an increase in mergers and acquisitions activity increased the supply of securities. *See* O'Sullivan, Mary, *The Expansion of the U.S. Stock Market, 1885—1930: Historical Facts and Theoretical Fashions*, Enterprise & Society, Vol. 8, No. 3, 2007, pp. 489–542, *available at* www.jstor.org/stable/23700715.

[6] *See* J. J. Archambault & M. Archambault, *Financial Reporting in 1920: The Case of Industrial Companies*, 37 The Accounting Historians Journal 53, 55 (2010), *available at* https://mds.marshall.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1007&context=acct_faculty ("Michael [1996] reports investor dissatisfaction with disclosure in the U.S. as early as 1900. Kohler [1926] expresses dissatisfaction with published financial information for analysis. This paper indicates that less than 20% of balance sheets could be considered useful for analysis. Senatra and Frishkoff [1984] echo the same concerns. While using reports from 1925, they could not perform adequate financial-statement analysis given incomplete income-statement information.").

[7] *See* Robert H. Montgomery, *What Have We Done, and How?*, *available at* http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1930/1937_1001_WhatMontgomeryT.pdf (hereinafter "Montgomery Address").

[8] *See* H. Rept. 1383, 73d Cong., 2d sess., at 11 (1934).

[9] With tens of billions of devices being connected together and a growing Internet of Things (IoT), data is ubiquitous, and is the foundation of many of the Internet-based tools we use. It enables research in virtually all fields of study. *See* Commissioner Kara Stein, *From the Data Rush to the Data Wars: A Data Revolution in Financial Markets* (Sept. 27, 2018), *available at* https://www.sec.gov/news/speech/speech-stein-092718.

[10] *See* Mary Jo White, *The Importance of Independence*, 14th Annual A.A. Sommer, Jr. Corporate Securities and Financial Law Lecture, Fordham Law School (October 3, 2013), *available at* https://www.sec.gov/news/speech/spch100113mjw; *see also* Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, Co*rporate Disclosure Effectiveness: Ensuring a Balanced System that Informs and Protects Investors and Facilitates Capital Formation, as part of a comment letter from Tom Quaadman, Vice President, Center for Capital Market Competitiveness, to Kevin O'Neill, Deputy Security of the Securities and Exchange Commission, and Lynn Powalski, Deputy Secretary of the Securities and Exchange Commission, RE: U.S. Chamber Report on Disclosure Effectiveness* (Jul. 29, 2014); Mary Jo White, Chair, Securities and Exchange Commission, *The Path Forward on Disclosure: Speech to the National Association of Corporate Directors' Leadership Conference* (Oct. 15, 2013), *available at* https://www.sec.gov/news/speech/spch101513mjw.

[11] *See* Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, Corporate Disclosure Effectiveness: Ensuring a Balanced System that Informs and Protects Investors and Facilitates Capital Formation (2014), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/07/CCMC_Disclosure_Reform_Final_7-28-20141.pdf.

[12] *See* U.S. Securities and Exchange Commission, *Disclosure Effectiveness*, https://www.sec.gov/spotlight/disclosure-effectiveness.shtml (last visited Oct. 22, 2018).

[13] *See* Tyler Gellasch, *Joint Report: Towards a Sustainable Economy: A Review of Comments to the SEC's Disclosure Effectiveness Concept Release*, at 14 (Sept. 2016), *available at* https://static1.squarespace.com/static/583f3fca725e25fcd45aa446/t/5866d3c0725e25a97292ae03/1483133890503/Sustainable-Economy-report-final.pdf.

[14] *See* Letter Re: Petition for a Rulemaking on Environmental, Social, and Governance (ESG) Disclosure authored by Osler Chair in Business Law Cynthia A. Williams, Osgoode Hall Law School, and Saul A. Fox, Distinguished Professor of Business Law, Jill E. Fisch, University of Pennsylvania Law School, and signed by investors and associated organizations representing more than $5 trillion in assets under management including the California Public Employees' Retirement System (CalPERS), New York State Comptroller Thomas P. DiNapoli,

Illinois State Treasurer Michael W. Frerichs, Connecticut State Treasurer Denise L. Nappier, Oregon State Treasurer Tobias Read, and the U.N. Principles for Responsible Investment (Oct. 1, 2018), *available at* https://www.sec.gov/rules/petitions/2018/petn4-730.pdf.

[15] *See* Betty Moy Huber and Michael Comstock, *ESG Reports and Ratings: What They Are, Why They Matter,* Harvard Law School Forum on Corporate Governance and Financial Regulation (Jul. 27, 2017), *available at* https://corpgov.law.harvard.edu/2017/07/27/esg-reports-and-ratings-what-they-are-why-they-matter/. "Most international and domestic public (and many private) companies are being evaluated and rated on their environmental, social and governance (ESG) performance by various third party providers of reports and ratings. Institutional investors, asset managers, financial institutions and other stakeholders are increasingly relying on these reports and ratings to assess and measure company ESG performance over time and as compared to peers." *Id.*

[16] In May 2018, the European Commission adopted a package of measures implementing (a) a regulation establishing the conditions and the framework to gradually create a unified classification system ('taxonomy') on what can be considered an environmentally sustainable economic activity; (b) regulation to disclosure obligations on how institutional investors and asset managers integrate environmental, social and governance (ESG) factors in their risk processes; and (c) amendment will create a new category of benchmarks comprising low-carbon and positive carbon impact benchmarks, which will provide investors with better information on the carbon footprint of their investments. *See* European Commission Website, *Sustainable finance*, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en (last visited Oct. 23, 2018).

[17] *See* David McCann, *Report Details Ubiquity of Non-GAAP Metrics*, CFO (Oct. 15, 2018), *available at* http://ww2.cfo.com/financial-reporting-2/2018/10/report-details-ubiquity-of-non-gaap-metrics/.

[18] *See* Jessica McKeon, *Long-Term Trends in Non-GAAP Disclosures: A Three-Year Overview*, Audit Analytics (Oct. 10, 2018), *available at https://www.auditanalytics.com/blog/long-term-trends-in-non-gaap-disclosures-a-three-year-overview/.*

[19] *See* Francine McKenna, *Study: Earnings Surprises Are Bigger, Thanks to Growing Use of Non-GAAP Metrics*, MarketWatch (Aug. 11, 2018), *available at* https://www.marketwatch.com/story/study-earnings-surprises-are-bigger-thanks-to-growing-use-of-non-gaap-metrics-2018-08-10*; see also* Paul Griffin and David Long, *Evidence of a Positive Trend in Positive Quarterly Earnings Surprise over the Past Two Decades* (July 2018), *available at* http://aaahq.org/Portals/0/newsroom/8318EarningsSurpriseMS.pdf.

[20] *See* Hans Hoogervorst, *Performance Reporting and the Pitfalls of Non-GAAP Metrics*, IFRS (May 11, 2016), *available at* https://www.ifrs.org/-/media/feature/news/speeches/hans-hoogervorst-

eaa-annual-conference-may-2016.pdf.

[21] *See id.*

[22] Emily Chasan, *Four Reasons Non-GAAP Metrics are Exploding*, Wall Street Journal CFO Journal (Jun. 25, 2013), *available at https://blogs.wsj.com/cfo/2013/06/25/four-reasons-non-gaap-metrics-are-exploding/.*

[23] *See* H. David Sherman & S. David Young, *The Pitfalls of Non-GAAP Metrics*, MIT Sloan Management Rev. (Nov. 20, 2017), *available at* https://sloanreview.mit.edu/article/the-pitfalls-of-non-gaap-metrics/.

[24] "In the matter of financial statements, the Commission is given authority to prescribe not only the forms in which statements shall be rendered, but also by what terms the various items of assets, liabilities, profit and loss, shall be designated. This feature of the act will undoubtedly contribute in large measure to the furnishing of more uniform and more informative financial reports to the investing public. That such an outcome is very much to be desired is surely not open to question if we have learned anything at all from the unhappy experiences of the last few years." Address of Garland S. Ferguson, Jr. on the Securities Act of 1933, Federal Trade Commission, Sept. 12, 1933.

[25] *In re Associated Gas & Electric Co.,* 11 S.E.C. 975, 1058-59 (1942).

[26] *See* Commissioner Kara M. Stein, *Mutualism: Reimagining the Role of Shareholders in Modern Corporate Governance*: *Remarks at Stanford University* (Feb. 13, 2018), *available at https://www.sec.gov/news/speech/speech-stein-021318.*

[27] *See* Chairman David S. Ruder, *Remarks Before the AICPA Sixteenth National Conference on Current SEC Developments* (Jan. 10, 1989), *available at* https://www.sec.gov/news/speech/1989/011089ruder.pdf.

[28] In 1938, the American Institute of Accountants – the predecessor of the American Institute of Certified Public Accountants (AICPA) – established the part-time Committee on Accounting Procedure, or CAP, to take on this role. Twenty-one years later, the AICPA handed the job over to another part-time group, the Accounting Principles Board, or APB. But by the early 1970s, many in the professional community were calling for the creation of a full-time, independent standard-setting group. This led to the formation of the FAF in 1972, and the creation of the FASB a year later.

[29] "This legislation aims definitely to shut the door for all time upon those financial methods of the past that brought disaster to thousands of investors and, to a great extent, destroyed the broad base of public confidence upon which our economic structure depends. As a program for the future it opens the way to a rebuilding of public confidence along new lines, along lines that promise untold benefit, not only to the great number of people who have their savings to invest in industry and in business, but also to those business and industrial organizations which

merit that confidence, and stand ready to deal with their investors as co-partners in a common enterprise.

. . . .

The outstanding purpose, I might say the principal purpose, of the Securities Act is that full disclosure shall be made of all material facts concerning an issue of securities that is offered for sale to the public. It stands squarely upon the principle that an investor whose savings are solicited for the uses and purposes of a corporation is entitled to be told the truth, the whole truth, and nothing but the truth. It proceeds upon the assumption that those who accept the trust of employing the money of other people in the conduct of business must let those people know the purposes for which their money is to be employed, and facts upon which they can exercise their own judgment as to the wisdom of their venture. Surely there is no element of startling radicalism in this requirement. It is the simplest requirement of common honesty. Common honesty which consists of telling all the truth and not merely the savory part of it, is the legal standard to which those who offer securities for public investment must conform. The only wonder is that the enactment of this standard of fair dealing has brought forth from some quarters the cry that it is dangerous and destructive, and will unduly hamper legitimate enterprise." Address of Garland S. Ferguson, Jr. on the Securities Act of 1933, Federal Trade Commission, Sept. 12, 1933, *available at* https://www.ftc.gov/system/files/documents/public_statements/685081/19330912_ferguson_the_new_securities_act_of_1933.pdf.

[30] The testimony of Colonel Carter, President of the New York State Society of Certified Public Accountants, before the Senate Banking and Currency Committee in 1933 was of great importance to public auditors: "The Committee considered at length the value to investors and to the public of an audit by accountants not connected with the company or management and whether the additional expense to industry of an audit by independent accountants was justified by the expected benefits to the public. The Committee also considered the advisability and feasibility of requiring the audit to be made by accountants on the staff of the agency administering the Act." U.S. Securities and Exchange Commission, Independence of Certifying Accountants, ASR No. 81 (Dec. 11. 1958).

[31] *Certified Public Accountants*, Fortune 5 (1932): 63.

[32] *See* Montgomery Address, *supra* note 7.

[33] Public Law107-204.

[34] For instance, the former Comptroller General of the United States testified to Congress ''that expanding auditors' responsibilities to report on the effectiveness of internal control over financial reporting would assist auditors in assessing risks for the opportunity of fraudulent financial reporting . . . internal control is the major line of defense in preventing and detecting fraud'' (Walker 2002).

[35] "The ICFR audit, performed by an independent, objective auditor, is

an important driver of trust in the integrity of financial reporting and helps facilitate capital formation in the U.S. markets." Letter from Council of Institutional Investors et al. to House Financial Services Committee regarding the Financial Choice Act 2017 (May 2017).

[36] *See* Cory A.Cassell, Linda A. Myers & Jian Zhou, *The Effect of Voluntary Internal Control Audits on the Cost of Capital* (June 1, 2013), *available at* https://ssrn.com/abstract=1734300; Sheryl-Ann K. Stephen & Pieter J. de Jong, *The Impact of Sarbanes-Oxley Act (SOX) on the Cost of Equity Capital of S&P Firms*, 13 J. of Applied Bus. & Econ. 102 (2012), *available at* http://www.na-businesspress.com/JABE/StephenSK_Web13_2_.pdf.

[37] *See* CAQ Pulse Poll: CFO Perspectives on the Sarbanes-Oxley Act (May 2017), *available at https://www.thecaq.org/caq-pulse-poll-cfo-perspectives-sarbanes-oxley-act.*

[38] *See* Weili Ge, Allison Koester & Sara McVay, *The Benefits and Costs of Sarbanes-Oxley Section 404(b) Exemption: Evidence from Small Firms' Internal Control Disclosures* (Sept. 2016), *available at* https://pcaobus.org/EconomicAndRiskAnalysis/CEA/Documents/benefit-cost-SOX-404b-Ge-Koester-McVay.pdf (finding that the 404(b) exemption had the effect of lowering the aggregate market value of subject firms by $935 million).

[39] *See* U.S. Securities and Exchange Commission, *Study of the Sarbanes-Oxley Act of 2002 Section 404 Internal Control Over Financial Reporting Requirements* (Sept. 2009), *available at* https://www.sec.gov/news/studies/2009/sox-404_study.pdf.

[40] *See* Dain Donelson, Matthew Ege & Joh McInnis, *Internal Control Weaknesses and Financial Reporting Fraud*, Auditing: A Journal of Practice & Theory, at 45-69 (Aug. 2017), *available at* http://aaapubs.org/doi/abs/10.2308/ajpt-51608?code=aaan-site.

[41] *See* AA Sommer, Jr., Commissioner, U.S. Securities and Exchange Commission, *The Legal Liability of the Accountant* (Sept. 1973).

[42] *See id.*

[43] *See U.S. v. Arthur Young & Co*, 104 S. Ct 1495, 1503 (1984). In 1995, Congress (in overriding a presidential veto) again called on the independent public accountant to assume the "role analogous to that of a detective, charged with the responsibility to 'ferret out fraud' and other illegal acts. *See* Andrew W. Reiss, *Powered by More Than GAAS: Section 10A of the Private Securities Litigation Reform Act Takes the Accounting Profession for a New Ride*, 25 Hofstra L. Rev. 1261 (1997), *available at* http://scholarlycommons.law.hofstra.edu/hlr/vol25/iss4/5.

[44] *See* Address of William Werntz, Chief Accountant, U.S. Securities and Exchange Commission, *What is Expected of the Independent Auditor: From the Viewpoint of the Investor* (Sept. 21, 1939), *available at* https://www.sec.gov/news/speech/1939/092139werntz.pdf.

[45] Letter from President Franklin D. Roosevelt to Congress (Mar. 29, 1933).